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Larry D. Soderquist

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I. Introduction

Supreme Court Justices rarely are experts in the highly specialized and difficult areas of law that have at their cores statutes administered by federal agencies. Securities law is one of these areas, and I will use it as a paradigm for the problems that result from Supreme Court decisionmaking by Justices who are uninformed about the law governing the specific issues of a case or about the general area of law out of which the issues grew.[1] Securities law cannot be understood on one's own. "[I]t is a puzzle that can be put together in many ways that look right, but only one of them is."[2] In this situation, uninformed decisionmaking translates to wrong decisionmaking, for unless one knows what the whole puzzle looks like when put together, it is virtually impossible to decide correctly what to do with an individual piece.

The adversarial process might reasonably be expected to solve this problem, but too often it does not, probably for three reasons. First, Justices know that they will not get, and should not get, an unbiased view from advocates. Second, a general knowledge of how a particular securities law issue fits into the structure of securities law is not usually provided by the adversarial process, which almost always focuses simply on specific issues. Third, most securities law cases are argued by general business litigators who rarely are securities law specialists.[3] Good litigators will, of course, try to become

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* Professor of Law and Director, Corporate and Securities Law Institute, Vanderbilt University; Joseph Flom Visiting Professor of Law and Business, Harvard University (Fall 1999). I wish to thank my research assistants, Karen Jordan and Arina Lekhel, for their helpful work on this essay.

1. The only Justice who stands out as a securities law expert is William O. Douglas. During 1936 and part of 1937 he was a member of the Securities and Exchange Commission, and he served as its chairman until he joined the Supreme Court in 1939. DOUGLAS OF THE SUPREME COURT 12, 14 (Vern Countryman ed., 1959).

2. LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS § 1.1 (3d ed. 1993, Supp. 1999).

3. Securities Exchange Act of 1934 § 16(b), 15 U.S.C. § 78p(b) (1974), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1999), under that Act provide exceptions. Cases involving one of those provisions often are handled by experts on the provision.

experts in the area of securities law involved in a case, but the problem they face is the one mentioned above: they cannot truly understand one part of, say, the Securities Act of 1933 (Securities Act),[4] without a knowledge of the Act as a whole.

If the adversarial process does not solve the problem, one might hope that the amicus briefs that frequently are filed by the Securities and Exchange Commission (Commission) would. It is likely that such briefs have prevented problems in decisionmaking, but since these problems did not occur, observers have no way of accessing how often a Commission brief has prevented a problem. What we do know from decided cases is that amicus briefs have not come close to solving the problem of uninformed decisionmaking, likely because the Commission properly has its own agenda and is viewed by Justices as essentially an extra advocate for one side or the other.

After discussing a sample of securities law cases where uninformed decisionmaking has been a problem in the Supreme Court, I will propose a solution. In doing so I am mindful that one should not lightly tamper with an institution that generally has worked well since the country's founding. On the other hand, it should not be surprising that some tinkering is necessary to fix a process devised two centuries ago by people who had no inkling of the legal complexities that would accompany the rise of the modern regulatory state. The secret is to tinker only to the extent essential, and to tinker in a way that is controlled by the Justices of the Court, so that the Justices can guide the process as they think best.

II. Examples of Uninformed Supreme Court Decisionmaking in Securities Law

The first examples of uninformed Supreme Court decisionmaking in securities law that I will discuss are from an area that is easiest for non-experts to deal with, since it involves the Supreme Court's own interpretation of the statutory definition of a security. In this area the Commission has not made rules, put out general interpretive releases, or otherwise intruded much into the area. Even so, the Court's uninformed decisionmaking itself has been a problem. What is worse, one of its decisions on the definition of a security has led to a serious problem in a later case where the Court confronted an issue deeply involved in rules, regulations, interpretations, and decisions by the Commission sitting in its quasi-judicial capacity. I will discuss that case at the end of this section.

The case to examine first on the issue of what is a security occurred in the 1940s after a company in Florida offered guests at its hotel the chance to purchase pieces of an orange grove, and a sister company offered the guests

4. 15 U.S.C. §§ 77a-77aa (1994 & Supp. III 1997).

management contracts under which all aspects of the growing and selling of the oranges would be handled by that company.[5] At the end of the harvest, any profits would be distributed according to the percentage of the grove held by each landowner.[6] The Commission sued the companies involved, saying they were offering a security called an investment contract (which is a security never encountered in that name; rather the concept of an investment contract is a legal construct used to pull various investment schemes under the coverage of the securities laws).[7] The issue reached the Supreme Court in *SEC v. W. J. Howey Co.*[8] In *Howey* the Court set out its test for an investment contract, saying: "The test is whether the scheme involves an investment of money in a common enterprise with [the expectation of] profits to come solely from the efforts of others."[9]

The *Howey* test still stands today, though as will be seen, what it actually now requires has been clouded by more recent decisions of the Supreme Court. More important, some later Supreme Court decisions involving the test easily can mislead non-experts as to what is a security because the Court's analysis does not fit within the well-developed interpretive structure of the securities laws, but instead appears to be sui generis.

An example is *United Housing Foundation v. Forman.*[10] *Forman* involved a housing cooperative, incorporated under a special New York statute, that offered shares of stock in the cooperative.[11] These shares entitled the owner to secure an apartment owned by the cooperative.[12] The most interesting aspect of the Supreme Court's decision relates to the "expectation of profits" element of the *Howey* test.[13] No profit could be made on the sale of the stock because, under the New York statute, the stock could not be sold for more than its original price.[14] However, significant space in the cooperative's buildings was leased to commercial interests, such as stores and laundries, and

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5. *See* SEC v. W. J. Howey Co., 328 U.S. 293, 295 (1946) (holding Howey liable for unregistered offering of security).

6. *Id.* at 296.

7. "Investment contract" is one of the securities listed in the definition of "security" found in Securities Act § 2(a)(1), 15 U.S.C. § 77b(a)(1) (Supp. III 1997).

8. 328 U.S. 293 (1946).

9. *W. J. Howey Co.*, 328 U.S. at 301. The Court found that the test was met and that the Howey companies had unlawfully offered securities, in that the securities had not been registered with the Commission and neither did the companies have available an exemption from the registration requirement of Securities Act § 5, 15 U.S.C. § 77e. *Id.*

10. 421 U.S. 837 (1975).

11. United Housing Found. v. Forman, 421 U.S. 837, 840-41 (1975).

12. *Id.* at 842.

13. *Id.* at 845.

14. *Id.* at 842-43.

the lease income could be traced directly to lower monthly maintenance payments on the apartments.[15] The plaintiffs argued that this satisfied the "expectation of profits" element. The Supreme Court disagreed, saying that this was "far too speculative and insubstantial to bring the entire transaction within the Securities Acts."[16]

This statement, and the general tenor of the opinion, are misleading to those uninitiated in securities law. They may well read the case as a blueprint for establishing an investment scheme that skirts the definition of "investment contract." In fact, doing that easily could trigger an enforcement action by the Commission, and the Commission would not care if some element of the *Howey* test were "insubstantial." *Forman* was decided the way it was because it did not involve an investment scheme, and the Court properly did not want to find that the case involved a security. The problem is that the Court did not appreciate that what it said in its decision could create mischief and misfortune.

Forman also leads to confusion about the Supreme Court's understanding of the "solely from the efforts of others" part of the *Howey* test. In *Forman* the Court reaffirmed the *Howey* test but then restated it differently, saying that the "touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[17] The switch from "solely from the efforts of others" to "the entrepreneurial or managerial efforts of others" came from a Ninth Circuit case, *SEC v. Glenn W. Turner Enterprises, Inc.*[18] That case involved a pyramid scheme that the Ninth Circuit clearly wanted to pull within the concept of an investment contract so the Commission could take action against those behind the scheme.[19]

If the *Forman* opinion stopped with its quotation from *Glenn W. Turner*, it would be understandable on this point. The opinion would, of course, be read to indicate that the Supreme Court was putting its imprimatur on the change away from "solely." In a curious footnote appearing on the same page, however, the Court said it "expressed no view" on the Ninth Circuit's holding in *Glenn W. Turner* that "solely" should be read flexibly rather than literally.[20] This makes opaque what the Supreme Court meant to say on the subject and

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15. *Id.* at 856.

16. *Id.*

17. *Id.* at 852.

18. 474 F.2d 476 (9th Cir. 1973).

19. *See* SEC v. Glen W. Turner Enters. Inc., 474 F.2d 476, 482-83 (9th Cir. 1973) (interpreting term investment contract to reach pyramid scheme). The problem under a straightforward reading of the *Howey* test is, of course, that the "investors" in a pyramid scheme are deeply involved in the scheme, mostly by bringing friends and neighbors to meetings run by the promoters of the scheme. Thus, profits are not to come "solely from the efforts of others."

20. United Housing Found. v. Forman, 421 U.S. 837, 852 n.16 (1975).

leaves one to suspect that the Court did not know the way through the thicket in which it was ensnared.

Yet another example of uninformed Supreme Court decisionmaking is *International Brotherhood of Teamsters v. Daniel.*[21] In this case the Court had to determine whether an investment contract was involved when employers, under a collective bargaining agreement, made contributions into a pension fund that was non-contributory on the part of employees.[22] Again the Court did not want to find that a security existed, partly because pensions had recently been subjected to extensive federal regulation under the Employee Retirement Income Security Act of 1974.[23] And again the way the Court treated the issue of whether a security existed could only lead non-experts into problems. The two best examples of such problems are the Court's handling of the "investment of money" and the "expectation of profits" elements of the *Howey* test.

It has always been understood that under *Howey* actual "money" need not be invested, but rather any consideration will do, and the Court in *Daniel* properly did not even mention the fact that the Teamster members were not alleged to be investing money, but rather labor.[24] In finding the "investment" element missing, however, the Court merely said cursorily that "it seems clear that an employee is selling his labor primarily to obtain a livelihood, not making an investment."[25] Although this is true, fringe benefits obviously are a significant form of compensation, so by use of the word "primarily" the Court can be said to have found that the employees were, in a not insignificant part, selling their labor as an investment in their pensions, which logically should meet the requirement of *Howey*. The Court, without discussion, did not find this to be so.

Daniel is also important in its handling of the "expectation of profits" element of the *Howey* test. In determining that this element was missing in *Daniel*, the Court based its decision on the fact that a relatively small portion of the Teamsters' pension fund had come from profits on the investment of contributions, with most of the fund having been derived from the contributions themselves.[26] This analysis is entirely at odds with securities law since the actual outcome of a scheme has nothing to do with whether a security exists. In fact, in most securities litigation investors have lost money.

21. 439 U.S. 551 (1979).

22. International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 553 (1979).

23. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 (1994); *see Daniel*, 439 U.S. at 569-70 (discussing influence of ERISA on security analysis).

24. *See Daniel*, 439 U.S. at 559 (discussing contribution of labor in context of "investment and money").

25. *Id.* at 560.

26. *See id.* at 562 (during twenty-two year period fund earned $31,000,000, while employee contributions totaled $153,000,000).

As with *Forman*, the *Daniel* decision easily can lead non-experts to believe that they can create an investment vehicle under protective cover provided by the Supreme Court. But if they tried, they quickly would find the hoped-for cover to be pervious. The way for the Court to have avoided this problem, and much casuistry,[27] would have been to decide *Forman* and *Daniel* by reference to the lead-in language to the definitions in the Securities Act. This language provides that the defined terms have the stated meanings "unless the context otherwise requires."[28] Then, the Court could have found that in the contexts of these cases no security existed.[29] This idea leads to two cases in which the Court did decide a "what is a security" issue by reference to the "unless the context otherwise requires" proviso.

One is *Reves v. Ernst & Young*,[30] which involved the issue of whether promissory notes issued by a farmers' cooperative were securities.[31] "Note" is the first item listed in the Securities Act's definition of a security,[32] yet not all notes are securities. The Commission and the courts have long found some kinds of notes to be securities and others not to be. The issue has been how to decide in which category to put a particular note. Most courts had used the "commercial-investment dichotomy,"[33] under which notes found to be commercial notes were not securities because the context required that

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27. I use the term in a non-pejorative sense. I do not blame the Justices or clerks of the Supreme Court for their mistaken understanding of securities law. As indicated at the beginning of this essay, securities law cannot be learned on one's own and is tricky in that it may seem that one has come to a correct conclusion because the conclusion flowed from diligent work and is logical. All the Supreme Court cases discussed in this essay show both diligence and logical legal reasoning. The problems in the syllogisms of the Court's reasoning were not in the conclusions but in the premises.

28. Securities Act § 2(a)(1), 15 U.S.C. § 77b(a)(1) (Supp. III 1997).

29. At one time there was a controversy about whether the context referred to in the lead-in to the definitions included the transactional context or was merely the linguistic context in the Securities Act, but it now is clear that both contexts are relevant. *See* Irving P. Seldin, *When Stock Is Not a Security: The Sale of Business Doctrine Under the Federal Securities Laws*, 37 BUS. LAW. 637, 669 n.79 (1982) (gathering materials concerning lead-in language to definition section of Securities Act).

30. 494 U.S. 56 (1990).

31. *See* Reves v. Ernst & Young, 494 U.S. 56, 58 (1990) (adopting family resemblance test and holding demand note in this case to be security).

32. Securities Act § 2(a)(1), 15 U.S.C. § 77b(a)(1) (Supp. III 1997).

33. *See, e.g.*, Holloway v. Peat, Marwick, Mitchell & Co., 900 F.2d 1485, 1487 (10th Cir. 1990) (using two-part approach based on "investment versus commercial" intent for determining when note is security prior to *Reves*), *cert. denied sub nom.* KPMG Peat Marwick v. Holloway, 498 U.S. 988 (1990); Futura Dev. Corp. v. Centex Corp., 761 F.2d 33, 40-41 (1st Cir. 1985) (finding investment/commercial test best); Hunssinger v. Rockford Bus. Credits, Inc., 745 F.2d 484, 488 (7th Cir. 1984) (explaining that both Seventh and Fifth Circuits use commercial/investment test).

finding.[34] When the Supreme Court decided *Reves*, however, it rejected this test and adopted instead the family resemblance test devised by the Second Circuit.[35]

The family resemblance test is complicated. It starts with the presumption that a note is a security.[36] To see if the presumption should be rebutted, a court compares the note in question with a list of varieties of notes that the Second Circuit had found were not securities, the purpose being to determine if there is a sufficient family resemblance for the note in question to be added to the list.[37] As an aid in making this comparison, the Court set out four factors to be considered.[38]

Two aspects of the Court's adoption and discussion of the family resemblance test indicate uninformed decisionmaking. First, the Court did not seem to understand that, while the test may have worked well in one circuit, it would inevitably lead to confusion over time as each circuit develops its own list of which notes are securities and which are not. Also, it appears in reading the opinion that the Court did not appreciate the subtleties involved in making the required comparisons.

More importantly, one of the four factors the Court said should be considered in the required comparison was phrased as follows: "We examine the 'plan of distribution' of the instrument . . . to determine whether it is an instrument in which there is 'common trading for speculation or investment.'"[39] At the same time, the Court noted that common trading does not require actual trading.[40] All this is impossible to understand, and one gets the impression that the failure of understanding comes from a failure of the Court to know how notes of various sorts are used in commerce and what effect this should have on securities law. The *Reves* Court focused on notes designed for trading in financial markets, failing to realize that a great many notes that are inarguably securities never leave the hands of one party and, more importantly, are not designed to do so. With this in mind, it is virtually impossible to know how to apply the "plan and distribution" factor in making the Court's required testing of family resemblance.

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34. As the terms imply, a commercial note is basically one that grows naturally out of a commercial transaction and is not made primarily for the purpose of return on investment, and an investment note is essentially one that is made for the purpose of such a return.

35. *Reves*, 494 U.S. at 64-65.

36. *Id.* at 67.

37. *Id.* at 63-64.

38. *See id.* at 66-67 (enumerating four factors to be considered: (1) motivations of parties, (2) plan of distribution, (3) reasonable expectations of investing public, and (4) other factors that may reduce risk of investment).

39. *Id.* at 66.

40. *Id.*

The other case to look at under the rubric of "unless the context otherwise requires" is *Landreth Timber Co. v. Landreth.*[41] This case involved the issue of whether common stock in a business corporation is a security when the context is a sale of a business by means of selling all or most of the outstanding stock of the corporation that serves as the vehicle for the business.[42]

At first thought it may seem impossible to conclude that common stock in a business corporation is not a security. It is, of course, the classic security. But to find common stock to be a security in this situation sets up a disturbing anomaly. When a business is being sold, the form the transaction is to take (for example, sale of stock, sale of assets, or merger) is almost entirely a technical decision made by the parties' lawyers and accountants. The primary issue for the parties is price; the issues for their lawyers and accountants are taxes and liability. Note, however, the incredible difference to the parties if stock is, in such a situation, a security. Hundreds of years of development of the law of contracts and fraud, which otherwise would tell the parties what they must disclose to each other, are swept aside and the "full disclosure" philosophy of the securities laws is substituted without a judicial decision having been made that this substitution makes real-world sense or advances justice.

In *Landreth,* the Court did not discuss how the securities law obligations of the seller could be met.[43] Nor did the Court appear to understand the import of the anomaly it created. Rather, the Court seemed simply to make its decision based on a literal view that stock is stock is stock, period, without exception, for no reason other than that common stock is the classic security. The opinion shows an uninformed view of what the full obligations of the securities laws entail. *Landreth* is important for that perspective, but it is more important in setting the stage for the Supreme Court case that best shows the uninformed nature of Supreme Court decisionmaking in securities law and the dangers that flow from that decisionmaking.

The case is *Gustafson v. Alloyd Co.*[44] Unlike the cases discussed above, which involved only the analysis of a definition in the Securities Act, *Gustafson* threw the Court into the heart of some of the most complex and tricky areas of the Act. These areas are characterized by rulemaking, the issuance of interpretive and policy releases, Commission decisionmaking in its quasi-judicial capacity, opinions by lawyers at the Commission, and informal understandings which came about as a result of decades of interactions between the Commission's staff and securities lawyers. The Supreme Court was working beyond its competence and did not know it, the decision having been based

41. 471 U.S. 681 (1985).

42. *See* Landreth Timber Co. v. Landreth, 471 U.S. 681, 683 (1985) (presenting question of whether sale of all stock of company is security subject to Securities Act).

43. *See generally Landreth,* 471 U.S. 681.

44. 513 U.S. 561 (1995).

on what appears to be almost a complete misunderstanding of the Securities Act. This being true, what otherwise would be rational and cogent discussions become gibberish.

The case involved the same essential facts as *Landreth*: the sale of a business by means of the sale of substantially all the stock of the business's corporate vehicle.[45] It is easy to speculate that part of the reason for bad decisionmaking in *Gustafson* was that the Court when faced with a case to decide, was not satisfied with the idea, arrived at with seeming ease in *Landreth*, that the securities laws apply in these situations.

In any event, in connection with the sale in *Gustafson*, the parties signed a purchase agreement that contained typical representations, warranties, and covenants.[46] After the purchase, some of the buyers became unhappy with the transaction and sued the sellers under Securities Act Section 12(a)(2), which provides a private remedy when someone sells a security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made, not misleading . . . ."[47] The buyers alleged that the sellers had made material misstatements in the purchase agreement and demanded rescission, as is provided in this section.[48]

In analyzing Section 12(a)(2), the Court chose to focus its discussion on the term "prospectus." It held that the term refers to a document of wide dissemination that is used in selling securities in public offerings not in private sales of securities.[49] Therefore, according to the Court, the purchase agreement in *Gustafson* could not be a prospectus. Speaking to congressional intent, the Court specifically found that "[t]he intent of Congress and the design of the statute require that § [12(a)(2)] liability be limited to public offerings."[50]

None of this fits within the accepted construct of securities law, and a traditional critique of the case is useless since its conclusions are based on a misunderstanding of the underlying law. The most pointedly telling statement in the opinion that shows the Court's lack of understanding is this: "Section 11 provides for liability on account of false registration statements; § [12(a)(2)] for liability based on misstatements in prospectuses."[51] From this statement,

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45. Gustafson v. Alloyd Co., 513 U.S. 561 (1995).

46. *Id.* at 565-66.

47. Securities Act of 1933, 15 U.S.C. § 77*l*(a)(2) (Supp. III 1997).

48. *Gustafson*, 513 U.S. at 566.

49. *See id.* at 575-76 (discussing congressional intent and legal definition of term "prospectus").

50. *Id.* at 578.

51. *Id.* at 571.

it is clear that the Court believed that the prospectus used in a public offering is one thing and the registration statement quite something else.

The problem is that the Court did not know how to read the Securities Act. An untutored reading of Securities Act Section 10,[52] which gives the requirements for a prospectus that meets the provisions of the Act, can lead to a belief by the uninformed that first a registration statement is prepared and then a prospectus is drafted based on information in the registration statement.[53] The fact is, this is exactly backwards. First, a prospectus is drafted containing all the information intended for investors, then a registration statement is created by adding a cover page at the front and a few innocuous pages at the back. The added pages contain such items as a list of the costs to be incurred in the offering, a consent by the accountants to have their audit opinion appear in the prospectus, and signatures of various parties.[54]

Put simply, there never has been and never will be a private lawsuit brought for disclosure problems in the non-prospectus part of a registration statement. Thus, the Court has read Section 11[55] (a long and detailed provision relating to private rights of action for disclosure problems in registration statements) and Section 12(a)(2) to cover the same problems. This could not have been, by any stretch, what the drafters envisioned. Neither could it have been what the Court would have desired if it had been informed enough to read Section 10 correctly.

Further, it is impossible to postulate a legislative intent that Section 12(a)(2) applies only to public offerings. Companies collectively do thousands of non-public offerings for every public offering.[56] This being the case, it is inconceivable that Congress meant to have two provisions giving securities purchasers a private right of action in public offerings (one Section 11, which works out the rules for liability in exquisite detail, and the other

52. Securities Act of 1933, 15 U.S.C. § 77j (1994).

53. Section 10(a) says that "a prospectus . . . shall contain the information contained in the registration statement [with specified exceptions]." Securities Act of 1933, 15 U.S.C. § 77j(a)(1).

54. Sometimes financial schedules are added, but they relate to the financial statements in the prospectus, and it would be almost impossible for a schedule to contain a disclosure problem that did not appear in a more important way in the financial statements themselves.

55. *See* Securities Act of 1933, 15 U.S.C. § 77*l* (outlining civil liability for false statements in registration material).

56. This is easily understood simply based on the costs of a public offering registered under the Securities Act. In a registered offering of a first-time registrant of, say, $5 million of securities, the compensation to the securities firms that sell to the public will be approximately $500,000, and legal and accounting fees, along with printing expenses, likely will come to another $500,000. In using the terms "public offerings" and "non-public offerings," this essay assumes that the offerings are legal. This will become important when discussing the liability provisions of the Act.

Section 12(a)(2), which would then be essentially a short and unnecessary appendage). It is even less conceivable that Congress intended to have in the Securities Act no provision protecting purchasers in the much more numerous non-public offerings.

Viewed the way the Commission, the courts, and securities lawyers have viewed the Securities Act for 62 years, Section 11 focuses on disclosure problems in registered public offerings, Section 12(a)(2) on disclosure problems in non-public offerings, and Section 12(a)(1)[57] on unlawful public offerings.[58] Summarized briefly, there are three types of offerings under the Securities Act: registered, exempt, and unlawful. And the drafters intended there to be three provisions to protect private plaintiffs in these offerings: Section 11, Section 12(a)(2), and Section 12(a)(1).

But this is only part of the story of uninformed decisionmaking in *Gustafson*, which, it must be remembered, involved a non-public offering. The Court said in *Gustafson* that it could not "accept the conclusion that [the term 'prospectus'] means one thing in one section of the Act and something quite different in another."[59] The Court never mentioned the law relating to registered public offerings and clearly did not appreciate the effect its decision, and especially this statement, could have in that area. Securities Act Section 2(a)(10) defines the term "prospectus."[60] The most basic part of the definition is that the term "means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale."[61] The Commission, courts, and securities lawyers have always realized that the beginning language just quoted – "means any prospectus" – refers to the prospectus contained in the registration statement and that the definition as quoted can be compressed to say that a prospectus is any written offer.[62] This compression is possible, of course, because the term "communication" encompasses all the items that precede it in the definition.

This understanding of what constitutes a prospectus under securities law is essential to an understanding of what can and cannot be done during the various periods of a registered public offering. There are three such periods: pre-filing (that is, before the registration statement is filed with the Commission), waiting (after the registration statement is filed), and post-effective

57. *See* Securities Act of 1933, 15 U.S.C. § 77*l*(a)(1) (discussing civil liabilities arising from sale of securities in violation of Act).

58. These are unregistered offerings for which no exemption is available.

59. Gustafson v. Alloyd Co., 513 U.S. 561, 573 (1995).

60. *See* Securities Act of 1933, 15 U.S.C. § 77b(a)(10) (Supp. III 1997) (defining term "prospectus").

61. *Id.* § 77b (a)(10).

62. Setting aside radio and television offers, which are rare.

(after the registration statement is effective). During the pre-filing period, no offer of securities may be made, so the issue of what constitutes a prospectus is irrelevant. During the waiting and post-effective periods, however, it is critical to know what a prospectus is because that issue determines what written offers may or may not be made.

Basically, the Securities Act provides in Section 5 that a prospectus meeting the requirements of Section 10 (which describes the prospectus that makes up the bulk of the registration statement) may be used during the waiting period and in specified circumstances must be delivered to buyers in the post-effective period.[63] The Act also provides that during the waiting and post-effective periods certain limited written offers may be made under exceptions to the definition of "prospectus."[64] Any other written offers are unlawful.

The concept of "offer" is extremely expansive under the Securities Act, mainly because the Commission has interpreted it to include anything that conditions the market for securities.[65] So, for example, a note by a securities salesperson to a customer saying "Phone me as soon as possible as my allotment is almost complete on this issue," has been held to constitute a prospectus.[66] Put simply, ever since 1933 written offers other than by the prospectus contained in a registration statement have been tightly constrained.

Under the language of *Gustafson*, however, all this could change if a court takes *Gustafson* beyond its holding and applies it to the area of securities registration. As indicated above,[67] the Court in *Gustafson* said that it could not "accept the conclusion that [the term 'prospectus'] means one thing in one section of the Act and something quite different in another." The Court also said that the term "prospectus" as defined in Section 2(a)(10) refers to documents of wide distribution,[68] and that "the word 'prospectus' is a term of art referring to a document that describes a public offering."[69] Under these statements, the law of what can and cannot be done during the course of a public offering could be thrown out and replaced by the idea that, during the waiting

63. *See* Securities Act of 1933, 15 U.S.C. § 77e (b) (1994) (discussing requirements of prospectus for compliance with section 10).

64. *See, e.g.*, Securities Act of 1933 § 2(a)(10), 15 U.S.C. § 77b(a)(10) (Supp. III 1997) (defining prospectus and providing criteria for certain communications to be deemed not prospectuses); Communications Not Deemed a Prospectus, 17 C.F.R. § 230.134 (1999) (setting forth Rule 134 and excepting certain writings as not prospectuses).

65. *See, e.g.*, Publication of Information Prior to or After the Effective Date of a Registration Statement, Securities Act Release No. 33-3844, 1957 WL 3605 (Oct. 8, 1957) (discussing SEC application of prospectus regulations).

66. *In re* Franklin, Meyer & Barnett, 37 S.E.C. 47, 49 (1956) (adjudicating sale of unregistered securities in violation of Securities Act of 1933).

67. *See supra* text accompanying note 59 (quoting Supreme Court in *Gustafson*).

68. Gustafson v. Alloyd Co., 513 U.S. 561, 575 (1995).

69. *Id.* at 584.

and post-effective periods, prospective buyers could be given any kind of promotional material, so long as it either was not widely distributed or it did not "describe[ ] a public offering."[70]

Certainly the Commission would be against these changes, as would most securities lawyers. The Commission wants to ensure that investors get full and fair disclosure, and this could not be ensured if securities firms were allowed to send out all manner of promotional materials during a registered offering. Securities lawyers would fear the liability that could easily accrue under Sections 11 or 12(a)(2) because of false or, especially, misleading statements (realizing here that anything short of full and fair disclosure is likely to strike a plaintiff's lawyer as at least misleading).

III. Proposed Solution to Uninformed Supreme Court Decisionmaking in Securities Law and Other Specialized Areas

Over the decades there have been a number of proposals to deal with the problems specialized areas of the law present for the Supreme Court. For example, Dean Erwin Griswold of Harvard Law School argued in 1944 that separate courts should be set up to be the final arbiters in certain specialized areas such as his own field of tax law.[71] Two decades earlier, Felix Frankfurter and James M. Landis,[72] then Harvard Law School professors, reviewed the history of proposals for change in the Supreme Court up to 1928, saying:

> The serious proposals made from time to time to increase the membership of the Court, to add temporary judges, to break up an enlarged Court into divisions, did not prevail. There are intrinsic limits to the size of a court if it is to be a coherent instrument for the dispatch of business and at the same time to observe the needs of consultation and deliberation.[73]

In 1999 Edward Lazarus, in a book giving readers a clerk's-eye-view of the workings of the Supreme Court, tells a story about clerks trying to get Justices to pay more attention to a particular study relating to the death penalty.[74] In that instance, he says, several clerks suggested the appointment of a special

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70. *Id.*

71. *See* Erwin Griswold, *The Need for a Court of Tax Appeals*, 57 HARV. L. REV. 1153, 1192 (1944) (discussing confusion arising from judicial misinterpretation of tax principles).

72. Incidentally, both authors were involved in creating the Securities Act, Felix Frankfurter as the New Deal staff member who put together the three person drafting team of which James Landis was a member. *See* James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 33-34 (1959) (documenting personal reflections on passage of Securities Act of 1933).

73. FELIX FRANKFURTER & JAMES M. LANDIS, THE BUSINESS OF THE SUPREME COURT 187 (1928).

74. EDWARD LAZARUS, CLOSED CHAMBERS: THE FIRST EYEWITNESS ACCOUNT OF THE EPIC STRUGGLES INSIDE THE SUPREME COURT (1999).

master,[75] which has been the Court's response when faced with border disputes between states, an area over which it has original jurisdiction.[76]

The problem with the aforementioned proposals is that they are too drastic; they give up too much of the system that has proven mostly to have worked and replace it with one having uncertain results. The historical proposal that would be most desirable is the establishment of specialized courts that would hear appeals from the various circuit courts of appeals. An alternative, of course, would be simply to have specialized courts of appeal, but allowing just one appeal would drastically alter the system for the development of law now in existence. There is much value in the current system, whereby circuit courts often come up with different judicial solutions until a conflict in the circuits is ripe for resolution in the Supreme Court. At the same time, having a securities supreme court, a tax supreme court, and so on (by whatever name) has a certain appeal. For one thing, it would solve the major problem discussed in this essay, since each such court would be comprised of experts. The results of establishing such courts are impossible to predict with accuracy. One can, however, postulate some of them.

One effect would be that federal agencies such as the Commission would be paid less deference than they now enjoy, not only by the specialized courts, but by all courts. This may not be bad, but it is impossible to tell. Certainly, at present, courts do pay deference to the Commission, and one does not hear complaints that courts pay the Commission too much deference. There is, therefore, reason to believe that the current system has that balance about right.

Another effect would be that the Supreme Court would hear more general subject matter cases, because of the burdens lifted from it. There would also be many more securities, tax, and other specialized cases heard by a court of final jurisdiction. Currently, for example, the Supreme Court decides few securities cases. With a specialized securities court taking a full docket from the various circuits, that number would increase by perhaps a hundred times. At an initial glance this may all seem to be beneficial, but whether it would be is another question.

First of all, under the current system we have a relatively unitary judicial and social philosophy emanating from the Supreme Court during a particular period. With specialized "supreme" courts promulgating decisions along with the current Court, one would expect divergences in judicial and social philosophy that have essentially nothing to do with the subject matter of the cases. Exactly how that would affect American society is hard to say, but the effect is more likely to be bad than good.

75. *See id.* at 202 (discussing Court's ideological resistance to appointment of special master).

76. U.S. CONST. art. III, § 2, cl. 1.

Second, cases would be heard by a "supreme" court before the relevant law has had as much time to develop in the various circuits as it does currently. This is an unhappy result, since there is not any widely held belief that circuit splits in important areas are waiting unduly long to be resolved, and there are clear benefits in allowing judicial experimentation to run its full course in the circuit courts.

Third, it likely would not be entirely beneficial if there were less variation among the circuits. It is probably a good thing that the law relating to, say, Federal Trade Commission matters, be allowed to differ from circuit to circuit, since judges can be expected to have a better sense of the prevailing social policy desires in their circuits than can Justices sitting in Washington.

Fourth, litigation costs would increase since more litigants would be able to make good their pledge to "take it all the way to the Supreme Court." Since the outcome of most of the "extra" appeals could be predicted fairly well, additional litigation would not be worth the money and the attendant upheaval that flows from litigation.

Finally, it is impossible to justify jurisprudentially the fact that a "supreme" court resolution would be much more available to litigants with cases involving specialized areas of law than it would be to all other litigants. It would provide grossly unequal access to justice if, for example, nine Justices devoted their efforts to securities law, nine to tax law, and the current nine to everything else.

As stated at the end of Part I above, the secret to solving the problem of uninformed Supreme Court decisionmaking is to tinker only to the extent essential, and to tinker in a way that is controlled by the Justices of the Court, so that the Justices can guide the process as they think best. With this in mind, I propose that the Court appoint what I would call counsels. These counsels would do some of the work now done by law clerks. The big differences would be that counsels (i) would be experts in a particular area in which the Court thought it could use assistance, (ii) would work only on a case by case basis, and (iii) would be appointed to serve the Court in general, rather than assigned to a single Justice.

The Court would choose experts in various areas, some ahead of time and some as the need arose, name each a "Counsel to the Supreme Court," and call on them as the Court wished in particular cases. Obviously the persons chosen would need to have certain qualities beyond expertise in a specialized area. They would have to be able to give the Court unbiased opinions, and they would need the confidence of the Justices. I would contemplate that any particular counsel would serve only on occasion, though obviously some would impress the Court to the extent that their services would be asked for more often than that of others. Congress should appropriate funds to pay counsels, but sufficient numbers likely could be found who would provide their expertise as a public service.

The big question is what specifically these counsels would do. Put simply, they would do what they are asked to do, and this would vary from case to case and from personality to personality. A counsel could be brought in at the time certiorari is considered. At that point an expert could give advice on the question of whether certiorari should be granted (based on expertise rather than social policy, upon which the Justices should need no advice). A counsel could be brought in to answer questions, in writing or orally, before the Justices take their preliminary vote on a case, with or without reading the briefs and listening to a tape of the oral arguments, as the Justices chose. A counsel could be made available to the Justices and their clerks for informal advice on all manner of subjects, from how to frame the issues in a decision to a suggestion simply of what books to consult. A counsel could be asked to review a draft opinion or even to write a draft. Obviously, the least change in the current workings of the Court would be simply to have a counsel review a draft opinion. If only that had been done in *Gustafson*, for example, a great mess could easily have been avoided.

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